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In The

Supreme Court of the United States

October Term, 1993

BFP,

Petitioner,

v.

Resolution Trust Corporation, As Receiver for Imperial Federal Savings Association, *et al.*,

Respondents.

On Writ of Certiorari to the
United States Courts of Appeals
For the Ninth Circuit

[redacted]

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether the consideration received from a noncollusive foreclosure sale that is conducted in conformance with applicable state law constitutes "reasonably equivalent value" under 11 U.S.C. § 548(a)(2)(A).

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

No. 92-1370

BFP,

Petitioner,

v.

RESOLUTION TRUST CORPORATION, AS RECEIVER FOR IMPERIAL FEDERAL SAVINGS ASSOCIATION, *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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BRIEF OF THE COUNCIL OF STATE GOVERNMENTS, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL LEAGUE OF CITIES, U.S. CONFERENCE OF MAYORS, AND THE INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

INTEREST OF THE *AMICI CURIAE*

Amici, organizations whose members include state, county, and municipal governments and officials throughout the United States, have a compelling interest in legal issues that affect state and local governments. The interpretation of 11 U.S.C. § 548(a)(2)(A) urged by petitioner would effect a significant displacement of state law

governing foreclosures. Because the authority to govern property transactions and to define property relationships has always been a critical component of state sovereignty, *amici* have an interest in protecting the States' traditional role in this area.

Moreover, *amici* have a broader interest in the development of jurisprudence governing the interpretation of both the Bankruptcy Code and other federal statutes in light of state interests and existing state law. In accordance with this Court's precedents, the Ninth Circuit correctly chose an interpretation of Section 548 which is consonant with state law, rather than one which would unnecessarily intrude on traditional state functions. *Amici* submit that the alternative readings of the statute adopted by other courts fail to take into account the federalism concerns with which this Court has traditionally imbued its interpretation of federal law where the displacement of state law in an area historically committed to state control is at issue. *See, e.g., CSX Transportation, Inc. v. Easterwood,* 113 S.Ct. 1732, 1737 (1993).

Because of the importance of these issues to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.[1]

STATEMENT OF THE CASE

Amici adopt the federal respondent's statement of the case.

SUMMARY OF ARGUMENT

1. This Court has clearly established that where a law enacted by Congress is alleged to conflict with the laws of the States, analysis "starts with the basic assumption that Congress did not intend to displace state law." *Maryland v. Louisiana,* 451 U.S. 725, 746 (1981). This precept is constitutionally required to "avoid[] unintended

[1] The parties have consented to the filing of this brief *amicus curiae*. Letters indicating their consent have been filed with the Clerk of the Court.

encroachment on the authority of the States," where, as here, the federal statute "pertain[s] to a subject traditionally governed by state law." *CSX Transportation, Inc. v. Easterwood,* 113 S.Ct. 1732, 1737 (1993).

Petitioner's interpretation of Section 548 would effect a significant displacement of state law governing property rights, an area that has traditionally been left to state control. Based upon a balancing of competing private property interests, state law has long prescribed foreclosure sale procedures and set forth the conditions for a foreclosure sale's validity and finality. Reading a federal standard of price adequacy into Section 548 would override these state laws, which almost universally prohibit setting aside a sale solely because the price is inadequate. *See, e.g., Matter of Winshall Settlor's Trust,* 758 F.2d 1136, 1139 (6th Cir. 1985).

Section 548, which, as its heading states, is aimed solely at the avoidance of "fraudulent transfers and obligations," allows a transaction to be avoided as constructively fraudulent where "less than a reasonably equivalent value" was received. 11 U.S.C. § 548(a)(2)(A). Section 548 lacks the "clear and manifest" expression of congressional intent which would be required to effect the encroachment into an area of traditional state authority advocated by petitioner. *See, e.g., Cipollone v. Liggett Group, Inc.,* 112 S.Ct. 2608, 2617 (1992) (citation omitted). There is absolutely no indication in the language of the provision or in its legislative history that Congress intended for Section 548 to displace state foreclosure law with case-by-case determinations of reasonable equivalence by federal bankruptcy courts, or that it intended for foreclosure sales valid under state law to be undone for their failure to meet a federal bankruptcy court's standard of price adequacy.

Accordingly, the Ninth Circuit correctly adopted a less intrusive construction of Section 548 which harmonizes with existing state foreclosure law. Given Congress's fail-

ure to attach any fixed meaning to the inherently ambiguous phrase "reasonably equivalent value," defining that statutory language as the sale price obtained in a foreclosure sale conducted in full accordance with state law is unquestionably a permissible construction. Indeed, the price which a property actually brings in a properly conducted, noncollusive foreclosure sale provides the best available measure of its "value" under such circumstances.

Moreover, because the Bankruptcy Code is superimposed upon a complex network of preexisting state law, *see Vanston Bondholders Protective Comm. v. Green,* 329 U.S. 156, 171 (1946) (Frankfurter, J., concurring), the underlying state law properly gives defining content to concepts found within that scheme, absent conflict with a federal interest. *See Butner v. United States,* 440 U.S. 48, 56 (1979) (adopting rule which "looks to state law to define the security interest of the mortgagee"). In analogous contexts, the Court has often resorted to state law to provide operative standards within a federal statutory scheme, where the creation of a federal rule would have the effect of overriding a traditional area of state authority. *See, e.g., De Sylva v. Ballentine,* 351 U.S. 570, 580-81 (1956).

Nor is a more disruptive interpretation required to effectuate the federal policy underlying Section 548—the protection of creditors from the diminishment of the bankrupt's estate through fraudulent conveyances—since state law and Section 548 share this goal. Because state foreclosure laws are designed to guard against fraud and collusion, Section 548's fraud prohibition is effectuated by compliance with those laws; there is no need for judicial second-guessing as to whether the price received in a foreclosure sale was "reasonably equivalent." Significantly, the policy of protecting creditors from fraudulent transfers has been codified for many centuries; yet prior to *Durrett v. Washington National Insurance Company,* 621 F.2d 201 (5th Cir. 1980), courts had not even considered the

idea that a foreclosure sale conducted in accordance with law could be invalidated as fraudulent.

In sum, the Ninth Circuit's interpretation—that the price received at a foreclosure sale conducted in full accordance with state law is, as a matter of law, one for "reasonably equivalent value"—accords with the language and purpose of the statutory provision, as well as with this Court's admonition that the Bankruptcy Code be read in light of overarching federalism concerns. *See, e.g., Kelly v. Robinson,* 479 U.S. 36, 49 (1986).

Imposing a federal rule of price adequacy as a measure of "reasonably equivalent value" would upset the balance state law—based on local conditions—has struck between the interests of mortgagors and mortgagees. That such a rule injects added uncertainty into the foreclosure sale process and potentially generates harmful economic effects —such as depressed bid prices, diminished availability of credit, and the like—has been noted by a number of courts and commentators. Even if there is less than complete consensus as to the economic consequences flowing from such a federal rule, the weightiness of the economic factors involved counsels deference to the choices that individual States have made.

While some may disagree with the precise manner in which certain States have balanced the competing interests of debtors and creditors, imbuing Section 548 of the Bankruptcy Code with a meaning not founded on congressional intent represents a misguided, constitutionally unacceptable, and ultimately counterproductive means of seeking to undo that balance. To the extent reform in state foreclosure law is sought, reform efforts should be directed to state lawmakers, not to federal bankruptcy courts.

In addition to the constitutional infirmity of using the Bankruptcy Code to perform an end-run around the state lawmaking process, such an approach is also undesirable

as a matter of policy. Allowing the fact of bankruptcy to trigger the reconsideration and possible avoidance of an otherwise valid foreclosure creates a problematic dual system whereby completed foreclosure transactions are treated differently depending upon whether the parties involved have resorted to the federal bankruptcy courts. Making the finality of a lawfully conducted foreclosure sale turn on the fact of bankruptcy runs directly counter to this Court's concern with "discourag[ing] forum shopping" and "prevent[ing] a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner*, 440 U.S. at 55 (citation omitted).

Finally, an unnecessarily intrusive interpretation of the Bankruptcy Code would serve to "reform" state foreclosure law only where foreclosures are followed by bankruptcy; state law would continue to control the finality of those foreclosures which are not followed by bankruptcy. The imposition of an added layer of federal protection for foreclosure sales followed by bankruptcy would make it all the more difficult for States to strike an appropriate balance as to the remaining cases. Indeed, the further development of state foreclosure law would likely be impeded by a rule making those laws largely irrelevant in all bankruptcy cases.

ARGUMENT

THE CONSIDERATION RECEIVED FROM A NON-COLLUSIVE FORECLOSURE SALE THAT IS CONDUCTED IN CONFORMANCE WITH APPLICABLE STATE LAW CONSTITUTES "REASONABLY EQUIVALENT VALUE" UNDER 11 U.S.C. § 548(a)(2)(A).

State foreclosure law almost universally declines to undo a sale for "mere inadequacy of price." *See Matter of Winshall Settlor's Trust*, 758 F.2d 1136, 1139 (6th Cir. 1985) (citation omitted).[2] Consequently, the construction of "reasonably equivalent value" urged by petitioner would necessitate a massive displacement of state law and procedure.[3] Under this Court's well-established principles for construing federal statutes which touch on areas of traditional state authority, such a construction is

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[2] *See also In re Madrid*, 21 B.R. 424, 427 (Bankr. 9th Cir. 1982), *aff'd*, 725 F.2d 1197 (9th Cir.), *cert. denied*, 469 U.S. 833 (1984)); Scott B. Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 Va. L. Rev. 933, 933 (1985) ("state preferences are reflected in the near-universal principle that a nonjudicial foreclosure sale will not be overturned, nor will confirmation of a judicial foreclosure be denied, because of 'mere inadequacy' in the price received at the foreclosure sale") (footnote omitted).

[3] Petitioner advocates the adoption of either of two alternative approaches to the Ninth Circuit's construction of Section 548(a)(2)(A). *See* Pet. Br. 40-44. One approach stems from the Fifth Circuit's holding in *Durrett v. Washington National Insurance Co.*, 621 F.2d 201 (5th Cir. 1980); the so-called "*Durrett* rule" stands for the proposition that a foreclosure sale realizing less than 70% of fair market value is avoidable in bankruptcy as a transfer for less than "reasonably equivalent value." The second approach is exemplified by the Seventh Circuit's holding in *Bundles v. Baker (In re Bundles)*, 856 F.2d 815 (7th Cir. 1988), which mandates a fact-specific, case-by-case analysis under Section 548(a)(2)(A). Both of these constructions supplant state foreclosure law by superimposing a federal test of "reasonably equivalent value" onto the analysis under Section 548. *See, e.g., Madrid*, 21 B.R. at 427 (*Durrett* rule would "radically alter" state law rules).

impermissible where, as here, a less intrusive alternative exists that is fully consistent with the language and purpose of the statute.

A. In The Absence Of A Clear Statement Of Congressional Intent, Federal Legislation Does Not Displace State Law Concerning Matters, Such As Property Rights, Which Have Traditionally Been Subject To State Authority.

A court construing federal legislation in an area historically subject to state authority must begin with the "basic assumption that Congress did not intend to displace state law." *Maryland v. Louisiana,* 451 U.S. 725, 746 (1981).[4] A finding that a federal statute impinges on "a subject traditionally governed by state law" is permissible only if it is " 'the clear and manifest purpose of Congress.' " *CSX Transportation, Inc. v. Easterwood,* 113 S.Ct. 1732, 1737 (1993) (quoting *Rice v. Santa Fe Elevator Corp.,* 331 U.S. 218, 230 (1947)).[5] This reluctance to find preemption in an area of traditional state control is essential to "avoiding unintended encroachment on the authority of the States." *Id.* Hence, federal statutes that could encroach upon state authority should be given a "fair but narrow reading," *Cippollone v. Liggett Group, Inc.,* 112 S.Ct. 2608, 2621 (1992) (opinion of Stevens, J.); where a statute is susceptible of more than one permissible interpretation, the one least disruptive of traditional state authority should govern.

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[4] *See* Felix Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Colum. L. Rev. 527, 539-40 (1947) (federal legislation affecting historic state functions "cannot . . . be construed without regard to the implications of our dual system of government"), *quoted in Kelly v. Robinson,* 479 U.S. 36, 49 n.11 (1986).

[5] *See also Cipollone v. Liggett Group, Inc.,* 112 S.Ct. 2608 (1992); *English v. General Electric Co.,* 496 U.S. 72, 79 (1990); *California v. ARC American Corp.,* 490 U.S. 93, 101 (1989).

This approach reflects the fact that federal law is "generally interstitial in its nature" and designed "to accomplish limited objectives"; hence, "[i]t builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose." Hart & Wechsler's *The Federal Courts and the Federal System* 470-71 (Paul M. Bator *et al.,* eds., 2d ed. 1973) *quoted in* Laurence H. Tribe, *American Constitutional Law* 316 (2d ed. 1988). Nowhere is this more true than in the bankruptcy context, where the federal statutory scheme builds upon a preexisting body of state property law. *See Butner v. United States,* 440 U.S. 48, 54-55 (1979); *Vanston Bondholders Protective Comm. v. Green,* 329 U.S. 156, 169-73 (1946) (Frankfurter, J., concurring).

Property law lies at the core of traditional state authority. *See, e.g., Butner,* 440 U.S. at 55 ("Property interests are created and defined by state law."); *Reconstruction Finance Corp. v. Beaver County,* 328 U.S. 204, 210 (1946) ("Concepts of real property are deeply rooted in state traditions, customs, habits, and laws.").[6] Specifically, a State's power to instill stability and certainty as to property holdings within the State and "declare what shall form a cloud on the title to such soil" has long been recognized. *American Land Co. v. Zeiss,* 219 U.S. 47, 60 (1911). "As it is indisputable that the general welfare of society is involved in the security of the titles to real estate and in the public registry of such titles, it is obvious that the power to legislate as to such subjects inheres in the very nature of government." *Id.* Because of this historic state power to create and control property relationships, a federal scheme is not lightly presumed to displace state property law.

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[6] *See also United States v. Fox,* 94 U.S. 315, 320 (1876) ("The power of the State to regulate the tenure of real property within her limits, and the modes of its acquisition and transfer, and the rules of its descent, and the extent to which a testamentary disposition of it may be exercised by its owners, is undoubted.").

In *United States v. Brosnan*, 363 U.S. 237 (1960), for example, the Court declined to adopt a uniform federal rule as to divestiture of junior tax liens, noting that "when Congress resorted to the use of [federal tax] liens, it came into an area of complex property relationships long since settled and regulated by state law." *Id.* at 241-42. Justice Harlan, writing for the Court, went on to explain:

> We think it more harmonious with the tenets of our federal system and more consistent with what Congress has already done in this area, not to inject ourselves into the network of competing private property interests, by displacing well-established state procedures governing their enforcement or superimposing on them a new federal rule.

Id. at 242.[7] As the court of appeals recognized, such concerns apply with equal force in this case.

B. The Court Of Appeals Correctly Construed Section 548(a)(2)(A) So As To Not Unnecessarily Disrupt State Foreclosure Law.

Openly acknowledging this Court's well-established principles of statutory construction—and the overarching federalism concerns they embody—the court of appeals correctly construed "reasonably equivalent value" by equating that language with the result obtained in a noncollusive foreclosure sale conducted in full conformance with state law. This construction is consistent both with the language and purpose of Section 548, and with this Court's

[7] The *Brosnan* Court recognized that its conclusion "would not, of course, withstand a congressional direction to the contrary." *Id.* at 242. Indeed, it appears Congress later superseded the *Brosnan* Court's holding by issuing such a contrary directive. *See Elias v. Commissioner*, 1993 U.S. Tax Ct. LEXIS 33, 100 T.C. No. 33 at 16-19 (Jun. 8, 1993) (citing the Federal Tax Lien Act of 1966, § 109, I.R.C. § 7425). This reaffirms the correctness of the *Brosnan* Court's approach in the absence of congressional guidance; if Congress in fact intends to override state law, it, rather than the courts, must supply the needed statutory clarification.

directive that the Bankruptcy Code be read in light of notions of federalism. *See Kelly v. Robinson*, 479 U.S. 36, 49 (1986).

1. A Construction Of Section 548 Which Defines "Reasonably Equivalent Value" In A Manner Consistent With State Law Fully Accords With The Stautory Language And Purpose.

In Section 548, Congress used the phrase "reasonably equivalent value" as a benchmark for the avoidance of certain transfers as constructively fraudulent,[8] but Congress did not define this phrase. In construing this language, two critical factors must be recognized at the outset. First, the term "reasonably equivalent value," like the notion of "value" itself, is inherently ambiguous. *See, e.g., Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 262 U.S. 276, 310 (1923) (Brandeis, J., concurring) ("[v]alue is a word of many meanings"), *quoted in Bundles*, 856 F.2d at 823. Second, Congress did not set forth any particular method by which "reasonably equivalent value" is to be determined.

Given these two factors, *amici* submit that a fair but narrow reading of Section 548 that gives appropriate respect to the long tradition of state regulation of foreclosures is, as the court below held, to use the price which a property brings at a noncollusive foreclosure sale conducted in accordance with state law as a definitive measure

[8] Section 548 provides, in pertinent part:

> § 548. Fraudulent transfers and obligations
>
> (a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
>
> * * * *
>
> (2)(A) received less than a reasonably equivalent value for such transfer or obligation . . . .

11 U.S.C. § 548(a).

of "reasonable equivalence."[9] In many analogous contexts, this Court has looked to state law to supply the definition of an ambiguous term in a federal statute[10] or determine the operative standard within a federal statutory scheme.[11]

But the court of appeals' construction of Section 548 is supported by far more than a due regard for the role

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[9] This reading of the phrase "reasonably equivalent value" is also supported by the fact that the Uniform Fraudulent Transfer Act (UFTA), adopted by over half the States, establishes just such a definition for "reasonably equiavlent value" for purposes of its state law analog to Section 548(a)(2)(A). Uniform Fraudulent Transfer Act, § 3(b), *in* 7A Uniform Laws Annotated 639, 650 (1985 & 1993 Supp.) ("For the purposes of Sections 4(a)(2) and 5, a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement."). Section 4(a)(2) of the UFTA closely tracks the language of Section 548(a)(2)(A) of the Bankruptcy Code. *See id.* at 653. Twenty-five States have adopted Section 3(b)'s definition of "reasonably equivalent value" as written; three more have adopted it with minor modifications. *See id.*, 1993 Supp. at 170, 175.

[10] *See De Sylva v. Ballentine*, 351 U.S. 570, 581-82 (1956) (term "children" in the federal Copyright Act defined by reference to state law).

[11] *See, e.g., Meyer v. United States*, 375 U.S. 233, 239 (1963) (adopting state rule as to the exemption of a widow's insurance benefits from federal tax lien on her husband's estate "[i]n the absence of a definitive statutory rule to the contrary," citing the "long-established policy" of incorporating state exemptions into bankruptcy law and other federal legislation); *Wallis v. Pan American Petroleum Corp.*, 384 U.S. 63, 68-71 (1966) (federal Mineral Leasing Act of 1920, which required that oil and gas leases be assignable, did not displace Louisiana law requiring that transfers be made by written agreement); *United States v. Yazell*, 382 U.S. 341, 348-58 (1966) (in seeking to recover balance due on a Small Business Administration loan, federal government was limited by state law of coverture governing a married woman's ability to bind separate property). *See also* Hart & Wechsler's *The Federal Courts and the Federal System* at 493-94 (collecting cases).

of state law in our federal system; the price attained at a lawful foreclosure sale is the most accurate method for determining the value of the property under the circumstances of a forced sale. Because the forced nature of a foreclosure sale depresses the price that will be obtained,[12] the "value" of a property within the context of a forced sale (such as a foreclosure sale or a sale in bankruptcy) will be lower than the value the property might have under different circumstances. Since it is the property's value in the context of a forced sale which is relevant to the "reasonable equivalence" analysis (rather than the hypothetical value the property might have in some other setting), the best—and only—way to arrive at that value is to observe the price a bidder is willing to pay at a noncollusive, lawfully conducted foreclosure sale. *See* Ehrlich, 71 Va. L. Rev. at 964-65 (discussing difficulty of assessing "forced sale price"). Indeed, the court in *Bundles* recognized that "[a]s a practical matter, the foreclosure sale price is the *only* means of measuring the effect of foreclosure on the value of the property." 856 F.2d at 824 (emphasis added).

Hence, the notion that the "value" of a piece of property can be conclusively established apart from the price it actually brings—a concept crucial to the *Durrett* analysis and to the arguments of petitioner and its *amici*—is simply false. The appraisals upon which a bankruptcy court would be forced to base its independent assessment of "reasonably equivalent value" are unlikely to be meaningful indicators of value. As commentators have noted, "[s]ubstituting an appraiser's opinion as to reasonably equivalent value merely results in the court looking to find what an imaginary buyer will pay an imaginary seller under unreal conditions, rather than finding what a real buyer and seller do in real circumstances." Alan S. Gover & Glenn D. West, *The Texas Nonjudicial Foreclosure*

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[12] *See, e.g.*, 1 Baxter Dunaway, *The Law of Distressed Real Estate* § 14.01 (1992) ("Generally property will not sell for as much in a foreclosure sale as it would after a leisurely marketing effort.").

Process—A Proposal to Reconcile the Procedures Mandated by State Law with the Fraudulent Conveyance Principles of the Bankruptcy Code, 43 Sw. L.J. 1061, 1080 (1990) (citing *Gillman v. Preston Family Inv. Co. (In re Richardson),* 23 Bankr. 434, 443 n.12 (Bankr. D. Utah 1982)). Indeed, variations in valuation methodology can yield dramatically different "fair market values" for the same property. *See* Robert M. Zinman, *Noncollusive, Regularly Conducted Foreclosure Sales: Involuntary, Nonfraudulent Transfers,* 9 Cardozo L. Rev. 581, 596 & n.63 (1987) (citing *In re Perido Bay Country Club Estates, Inc.,* 23 Bankr. 36 (Bankr. S.D. Fla. 1982), in which "appraisals considered by the court ran from $7.8 million to $13.4 million").[13]

Significantly, Congress did not choose to use the more exacting phrase "fair market value" in Section 548, as it did elsewhere in the Code.[14] Moreover, Congress never indicated that there was any fixed relationship between the concept of "reasonably equivalent value" and that of "fair market value"; it certainly did not specify any rigid mathematical ratio that would link the two concepts. Hence, there is no statutory support for an approach, such as that used in *Durrett,* which assumes that an immutable mathematical relationship exists between "fair market value" and "reasonably equivalent value." In fact, as Professor Ehrlich has explained, it makes no sense to attempt to draw comparisons between these two very dif-

[13] *See also id.* at 594-95 (*Durrett* approach "tends to ignore the vast understatement that real estate valuation is not an exact science, and to overlook the variables that go into the determination of such values").

[14] *See* Br. of Federal Respondent on Petition at 6 n.3 (citing 11 U.S.C. § 522(a)(2)). As the Solicitor General notes, the concept of "fair market value," which refers to "the value the property would have brought in a transaction between a willing buyer and a willing seller, neither being under any compulsion to buy or sell," could not be applied to a foreclosure sale, since the forced nature of the sale creates downward pressure on the price. *Id.*

ferent kinds of "value." *See* Ehrlich, 71 Va. L. Rev. at 964-65 ("To set about determining, as the *Durrett* courts have, whether sixty or seventy percent of fair market value is reasonable under the circumstances of a forced sale is an inherently arbitrary comparison of two unrelated values.") (footnote omitted).

The legislative history is, like the statute, devoid of any indication of precisely what Congress meant by "reasonably equivalent value." Contrary to the assertions of petitioner, *see* Pet. Br. at 28-29, 44-47, the fact that Congress's 1984 amendment of Section 548 brought foreclosure sales generally within the ambit of avoidable "transfers" by adding the language "voluntarily or involuntarily" to Section 548(a) has no bearing on what it meant by "reasonably equivalent value."[15] The mere fact that involuntary transfers are encompassed within the universe of transfers which may be avoided for failure to realize "reasonably equivalent value" suggests no congressional position as to whether noncollusive foreclosure

[15] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 463, 98 Stat. 333, 378-79 (1984) (codified at 11 U.S.C. § 548(a)). The 1984 Amendments also changed the definition of "transfer" in § 101 of the Bankruptcy Code to clarify that "foreclosure of the debtor's equity of redemption" was encompassed. *Id.*, 98 Stat. at 368, § 421 (codified at 11 U.S.C. § 101(48)).

While this changed language may have overruled the holding of the Ninth Circuit in *Lawyer's Title Insurance Corp. v. Madrid,* 725 F.2d 1197 (rejecting a Section 548 challenge to price adequacy of a foreclosure sale on the grounds that foreclosure sales were not transfers), it did not, contrary to petitioner's assertion, Pet. Br. 29, disturb the holding of the Bankruptcy Appellate Panel in *Madrid.* 21 B.R. 424 (holding that the price obtained at a noncollusive foreclosure sale conducted in accordance with state law is necessarily one for "reasonably equivalent value"). *See In re Verna,* 58 B.R. 246, 251 (Bankr. C.D. Cal. 1986).

sales conducted in full accordance with state law meet that "reasonably equivalent value" standard.[16]

Contrary to the assertions of petitioner and its *amici*, the court of appeals' approach does not draw a distinction between foreclosure sales and other transfers that is at odds with the statutory language or create an "exception" to Section 548 for foreclosure sales. *See* Pet. Br. at 27-28; Br. *Am. Cur.* Frank Allen at 7 (arguing that there is "no exception stating that foreclosure sales are exempt from the avoidance powers of the Trustee"); *id.* at 17, 23. It merely recognizes that foreclosure sales, unlike other transfers, are already subject to a state law process that constitutes the best available means of determining "reasonably equivalent value."

Nor does recognizing this fact render Section 548's inclusion of foreclosure sales meaningless. Where foreclosure sales meet the test of "reasonably equivalent value," they, like other transfers for reasonably equivalent value, simply fall outside the scope of the avoidance powers described in Section 548. However, foreclosure sales which are *not* conducted in accordance with state law, or which involve some other element evidencing fraud, remain voidable under Section 548. *See* 11 U.S.C.

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[16] Nor, contrary to the assertion of petitioner's *amici*, *see* Br. *Am. Cur.* Frank Allen at 30-31, can any congressional position as to the meaning of "reasonably equivalent value" be derived from Congress' failure to adopt a proposed amendment that would have effectively overruled the *Durrett* approach and codified the approach of the *Madrid* Bankruptcy Appellate Panel. As was noted in *In re Verna*, this provision was struck on a point of order by Senator Metzenbaum, who objected because the "issue had not been considered in committee." 58 B.R. at 250; *see* Robert M. Zinman, James A. Houle & Alan J. Weiss, *Fraudulent Transfers According to Alden, Gross and Borowitz: A Tale of Two Circuits*, 39 Bus. Law, 977, 980 n.17 (1984). Hence, there is no evidence to support the contention that "Congress thereby refused to overrule *Durrett*." Br. *Am. Cur.* Frank Allen at 30.

§ 548(a)(1) (discussing transfers made "with actual intent to hinder, delay, or defraud").

Hence, nothing in the language or legislative history of Section 548 evinces a clear congressional intent to rule out compliance with state procedures as a proper and sufficient means of establishing "reasonably equivalent value." This Court's precedents indicate that state law should not be displaced in such circumstances unless it would frustrate the statutory purposes Congress was seeking to achieve.[17] *See English*, 496 U.S. at 79. An examination of the purpose underlying Section 548's fraudulent transfer provisions, however, only confirms the advisability of making compliance with state foreclosure law the defining characteristic of "reasonably equivalent value."

Section 548 is expressly directed at undoing fraudulent conveyances; it thus represents the latest in a long line of codified fraudulent conveyance provisions beginning over four hundred years ago with the Statute of 13 Elizabeth. *See* S. Rep. No. 989, 95th Cong., 2d Sess. at 89, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5875 (citing 13 Eliz. c. 5

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[17] A reading of Section 548 which defines "reasonably equivalent value" by reference to state law does not, of course, conflict with Congress' constitutional power to establish uniform bankruptcy laws. U.S. Const., Art. 1, § 8, cl. 4 (providing that Congress has the power to establish "uniform Laws on the subject of Bankruptcies throughout the United States"). *See, e.g., Butner*, 440 U.S. at 54 n.9 ("Notwithstanding this requirement as to uniformity the bankruptcy acts of Congress may recognize the laws of the state in certain particulars, although such recognition may lead to different results in different States.") (quoting *Stellwagen v. Clum*, 245 U.S. 605, 613 (1918); *Vanston Bondholders*, 329 U.S. at 172-73 (Frankfurter, J., concurring) ("To establish uniform laws of bankruptcy does not mean wiping out the differences among the forty-eight States in their laws governing commercial transactions . . . . These differences inherent in our federal scheme the day before a bankruptcy are not wiped out or transmuted the day after."); *Hanover National Bank v. Moyses*, 186 U.S. 181, 190 (1902) (federal bankruptcy law, in recognizing local exemptions, did not violate uniformity requirement).

(1570)); Zinman, Houle & Weiss, 39 Bus. Lawyer at 977. The purpose of these earlier codifications was the same as that of Section 548—the desire to prevent a debtor from making fraudulent transfers to the detriment of his creditors. *See* S. Rep. No. 989 at 89, 1978 U.S.C.C.A.N. at 5875. Because of the difficulty of proving an intent to defraud, however, certain "badges of fraud" were identified which could make a transfer avoidable, such as a transfer to family members or a transfer for grossly insufficient value; such transfers were deemed to be constructively fraudulent. *See* William H. Henning, *An Analysis of Durrett and Its Impact on Real and Personal Property Foreclosures: Some Proposed Modifications*, 63 N.C.L. Rev. 257, 260 (1985); Zinman, Houle & Weiss, 39 Bus. Lawyer at 989.

The doctrine of *constructive* fraud, therefore, is a means of identifying and undoing instances of *actual* fraud, where intent is difficult or impossible to prove. Hence, "the purpose of the badges, presumptions, and finally the constructive fraud provisions was to develop methods of ferreting out those transactions that are inequitable to creditors by the debtor's deliberate design or indifference." Zinman, *Nonfraudulent Transfers*, 9 Cardozo L. Rev. at 584. Where a transfer takes place without any legal oversight, an independent evaluation of price adequacy is necessary under Section 548 to determine whether "reasonably equivalent value" was received; a too-low price in such circumstances signals that something fraudulent may have occurred. There is no need for a second, duplicative legal review, however, when a transfer takes the form of a noncollusive foreclosure sale conducted in full accord with state laws which are specifically designed to protect against fraud.[18]

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[18] While state foreclosure laws differ, a number of very significant procedural protections are commonly provided. Procedures governing advertising, bidding, and post-sale ratification and audit are all designed to protect the process from fraud and facilitate the attainment of a reasonable price. *See generally*, David H. Fishman, *The Foreclosure Sale, in Real Estate Foreclosures* 47 (American College of Real Estate Lawyers, ed., 1992). For example, "[i]t is a universal principle of foreclosure law that the foreclosing trustee and mortgagee and the successful bidder may not acquire the property through a foreclosure sale in which anything has been done to 'chill' the bidding." *Id.* at 54. A sale can be set aside (or not confirmed) if state procedural laws were violated or if elements such as fraud, mistake, or unfairness were involved. *See id.* at 54-56; 1 Baxter Dunaway, *The Law of Distressed Real Estate* §§ 14.02[1] & [2][b].

Foreclosure sales are thus unique among the broad spectrum of transfers brought within Section 548's wide sweep in that they carry with them—pursuant to state law—the very protections against fraud which Section 548 is designed to provide. Where state foreclosure law protections are strictly applied, they are fully adequate to arrive at a measure of "reasonably equivalent value" which fulfills the purposes underlying Section 548. Given the foregoing, it is not surprising that despite the long history of fraudulent conveyance statutes, no court prior to *Durrett* had ever suggested that a foreclosure sale conducted in accordance with the applicable law could be avoided as fraudulent. *See Bundles*, 856 F.2d at 820 (citing *Madrid*, 21 B.R. at 426); *Abramson v. Lakewood Bank and Trust Co.*, 647 F.2d 547, 550 (5th Cir. 1981) (Clark, J., dissenting), *cert. denied*, 454 U.S. 1164 (1982); Zinman, Houle & Weiss, 39 Bus. Law. at 977, 986-87.

Efforts to attribute a broader purpose to Section 548, such as the preservation of the bankrupt's estate for distribution to unsecured creditors,[19] are misplaced in light of the historically limited function of fraudulent transfer statutes, *see* Zinman, Houle & Weiss, 39 Bus. Law. at

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[19] *See* Pet. Br. 34 ("the purpose of 11 U.S.C. Section 548 is to recover property for the estate of the bankrupt"); Br. *Am. Cur.* of Frank Allen at 22-23 ("purpose of § 548 is to recover for the estate assets that could be distributed to unsecured creditors").

986-95, and the fact that other provisions of the Bankruptcy Code are designed, within carefully crafted limits, to advance such other purposes.[20] Similarly without merit is the allegation that the court of appeals' construction of Section 548 conflicts with a broad congressional interest, embodied in the Bankruptcy Code as a whole, of preserving the debtor's estate for equitable distribution to creditors. While the preservation of the debtor's estate may be among the themes that runs through the statutory scheme, Congress has never evidenced a single-minded intent to expand without limit the bankrupt's estate, regardless of the cost of doing so or the competing interests involved. *Cf. Pacific Gas & Electric Co. v. State Energy Resources Conservation & Development Comm'n,* 461 U.S. 190, 220, 222 (1983) (rejecting argument that California's moritorium on nuclear power plants "frustrates the Atomic Energy Act's purpose to develop the commercial use of nuclear power"; while promotion of nuclear power was a central purpose of the Act, there was no congressional intent to pursue it "at all costs"); Tribe, *American Constitutional Law* at 488-89.

Instead, each provision in federal bankruptcy legislation represents the balancing of competing interests necessary to serve the narrowly-drawn purposes expessed therein. *Cf. Lewis v. Manufacturers Nat'l Bank of Detroit,* 364 U.S. 603, 609 (1961) (discussing "balance" that was struck by Congress in § 70 of the Bankruptcy Act "between secured and unsecured creditors"); *id.* at 608 n.6 (limits on avoidance power of trustee necessary to protect interests of creditors) (quoting H.R. Rep. No. 745, 86th Cong., 1st Sess. at 8-9 (1959)). Section 548 em-

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[20] *See, e.g.,* 11 U.S.C. § 547 (making certain preferences avoidable); H.R. Rep. No. 595, 95th Cong., 2d Sess. 178, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138-39 ("preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor"); *see also* Zinman, *Nonfraudulent Transfers,* 9 Cardozo L. Rev. at 585 n.22.

bodies a balance between the need to protect the bankrupt's estate from fraud and the competing need to leave untouched nonfraudulent transfers entered into prior to bankruptcy; it does not stand for the proposition that *any* pre-bankruptcy transfer which arguably reduces the size of the bankrupt's estate should be summarily undone.

2. *The Court Of Appeals' Construction Is Mandated By The Requirement That The Bankruptcy Code Be Read In Light Of Notions Of Federalism And The Preexisting Body Of State Law.*

Not only was the court of appeals' interpretation of Section 548 correct given the language and purpose of the statutory provision, it was affirmatively required by the principles of construction this Court has applied to the Bankruptcy Code. The Court has emphasized that, like other federal statutes which touch upon matters traditionally governed by the States, the Bankruptcy Code must be read in light of notions of federalism. *See, e.g., Kelly v. Robinson,* 479 U.S. 36, 49 (1986).

This reluctance to read the Bankruptcy Code in a manner which is unnecessarily intrusive of traditional areas of state authority reflects the fact that federal bankruptcy law builds upon a preexisting body of state law. *See Vanston Bondholders,* 329 U.S. at 171 (Frankfurter, J., concurring) ("[b]ankruptcy legislation is superimposed upon rights and obligations created by the laws of the States"). While Congress may, through its Bankruptcy power, affect state-created property rights and relationships, the preexisting state property law system remains intact until Congress affirmatively chooses to do so.

The Court has long held that the overlay of federal bankruptcy law does not alter the underlying state law, except insofar as state law actually conflicts with or frustrates the purpose of the federal bankruptcy statute. *See, e.g., Butner,* 440 U.S. at 54 n.9 (state laws are "suspended only to the extent of actual conflict with the

system provided by the Bankruptcy Act of Congress") (citations omitted); *Stellwagen v. Clum*, 245 U.S. 605, 615 (1918) ("It is only state laws which conflict with the bankruptcy laws of Congress that are suspended; those which are in aid of the Bankruptcy Act can stand.") (citing *Miller v. New Orleans Acid & Fertilizer Co.*, 211 U.S. 496 (1909)).[21]

For example, in *Butner v. United States*, 440 U.S. 48 (1979), the Court held that since Congress had not formulated a rule "defining the mortgagee's interest in the rents and profits earned by property in a bankrupt estate," *id.* at 54, such interest must be determined by reference to state law. Noting that "[p]roperty interests are created and defined by state law," the Court held that "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* at 55.[22] *See also Vanston Bondholders*, 329 U.S. at 161 ("What claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, is

[21] *See also Sturges v. Crowninshield*, 17 U.S. (4 Wheat) 122, 196 (1819) ("It is not the right to establish these uniform [bankruptcy] laws, but their actual establishment, which is inconsistent with the partial acts of the States."). Of course, a state law which actually conflicts with the purposes of federal bankruptcy legislation cannot stand. For example, in *Perez v. Campbell*, 402 U.S. 638 (1971), the Court found that the Arizona Motor Vehicle Safety Responsibility Act, which provided that a discharge in bankruptcy would have no effect on certain accident-related obligations, conflicted with the statutory purpose of giving debtors a "new start" and hence was invalid.

[22] The *Bundles* court's contention that *Butner* is inapplicable in this context because it dealt with an instance of complete federal silence on an issue, *see Bundles*, 856 F.2d at 822, is unconvincing. While Section 548 is a federal rule concerning the circumstances in which a transfer may be avoided, Congress was nevertheless silent on the one matter at issue here—the means by which "reasonably equivalent value" is to be assessed.

a question which, in the absence of overruling federal law, is to be determined by reference to state law.") (footnote and citations omitted).

In sum, the court of appeals appropriately resolved the ambiguity in the phrase "reasonably equivalent value" in a manner consonant both with the principles of federalism repeatedly enunciated by this Court and with the congressional purpose underlying Section 548. The only alternative to resolving Section 548's ambiguity in a manner harmonious with existing state foreclosure laws is for the federal bankruptcy courts to create a new federal rule out of whole cloth. Such an imposition of a judicially-created rule ignores the assumption that when Congress intends to "radically readjust[] the balance of state and national authority" it will be "reasonably explicit" in making that adjustment, rather than "entrust[ing] its attainment to that retrospective expansion of meaning which properly deserves the stigma of judicial legislation." Frankfurter, *Some Reflections on the Reading of Statutes*, 47 Colum. L. Rev. at 540; *see also Kelly*, 479 U.S. at 49 n.11.

Because Congress provided no suggestion—much less an explicit one—that a court should interpret "reasonably equivalent value" in a manner disruptive of state law, the proposed federal formulations offered by other courts of appeals represent unwarranted judicial intrusions into areas historically committed to state authority. Whether that intrusion takes the form of the strict mathematical measure for "reasonable equivalence" (as in *Durrett* and its progeny) or a fact-intensive, case-by-case federal review of price adequacy (as in *Bundles*), the result is the same: longstanding state law is displaced by a federal judge without any sign that Congress intended such an outcome.

C. Imposing A Federal Standard Of Price Adequacy On Lawful Foreclosure Sales Disrupts The Balance States Have Struck Between The Interests Of Mortgagors And Mortgagees And Is An Improper Way To Change State Foreclosure Law.

State foreclosure laws represent a balancing of the interests of mortgagors and mortgagees based on local conditions and provide numerous protections to ensure the fairness of the process.[23] "The history of mortgage law has seen a long series of tradeoffs as equity courts and legislatures developed procedures to balance the rights of the lender and borrower." Zinman, *Nonfraudulent Transfers*, 9 Cardozo L. Rev. at 603. There may be disagreement as to exactly where the balance between mortgagors and mortgagees should be struck in a particular jurisdiction.[24] Under our federal system, however, credence "should be given to each state's determination of what that balance should be, given the circumstances that exist in that jurisdiction." *Id.*

Superimposing a nationwide federal standard of price adequacy onto the analysis of foreciosure sales under Section 548 completely upsets the balance arrived at by each State's laws. *See e.g.*, A.B.A. Section of Real Property, Probate and Trust Law, *Report No. 2 of the Section*

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[23] State laws contain judicial and legislative limits on foreclosures "designed particularly to insure that the foreclosed property is not sold for an inadequate price at the foreclosure sale." 1 Baxter Dunaway, *The Law of Distressed Real Estate* § 14.01 at 14-2; *see generally id.*, Chapter 14; Fishman, *The Foreclosure Sale, in Real Estate Foreclosures* at 47-56.

[24] *See generally* Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. Cal. L. Rev. 843 (1980) (critiquing mortgage sale process). Nevertheless, Washburn recognizes the economic and fairness difficulties associated with "overly burden[ing] the lender," *id.* at 938, and acknowledges that "[b]alancing the equities [between mortgagors and mortgagees] is difficult, since the parties should be neither unfairly advantaged nor unfairly punished." *Id.* at 939.

of Real Property, Probate and Trust Law in *Annual Report of the A.B.A.*, Vol. 108 at 1089, 1091 (1983) ("ABA Section Report") (*Durrett* approach "will play havoc with state foreclosure and default statutes which are designed to effect a fair balance between the rights of the creditor and the rights of the debtor"). The negative economic effects associated with the increased uncertainty such a disruption entails have been duly noted by courts and commentators alike.[25] While there may not be unanimous consensus as to the precise economic consequences of the additional uncertainty which such a federal rule injects into the foreclosure process,[26] the potential for profound unintended economic consequences counsels deference to the legal and political choices made by individual States, in the absence of a clear congressional directive to upset those choices.

Those urging an interpretation of Section 548 which would make lawfully conducted foreclosure sales avoid-

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[25] *See, e.g., Abramson*, 647 F.2d at 550 (Clark, J., dissenting) (the "cloud upon mortgages" cast by majority's approach "tends to depress further the prices of foreclosure sales"); *In re Alsop*, 14 B.R. 982, 987 (Bankr. D. Alaska 1981) ("The specter of th[e] uncertainty [presented by *Durrett* rule] will severely inhibit participation at the foreclosure sale by anyone other than the original creditor, thus depressing bid prices to the general detriment of debtors."), *aff'd* 22 B.R. 1017 (D. Alaska 1982); Ehrlich, 71 Va. L. Rev. at 963-64 (1985) ("potential buyers will discount their assessment of the true market value of the property to reflect this uncertainty"); Lawrence D. Coppel & Lewis A. Kann, *Defanging Durrett: The Established Law of "Transfer"*, 100 Banking L.J. 676, 682 (1983) ("impact of *Durrett* is . . . . to undermine the very foundation of the entire secured lending sector of the national economy, that is, the lender's ability to realize on its security"); ABA Section Report at 1090 ("[c]reditors will hesitate to make any mortgage loans under conditions where they may not be able to realize upon their security in the event of default").

[26] *Compare* Philip Schuchman, *Data on the Durrett Controversy*, 9 Cardozo L. Rev. 605 (1987) *with* Robert M. Zinman, *Durrett Data: Shucking the Husks from the Grain*, 9 Cardozo L. Rev. 1013 (1988).

able appear to be largely motivated by the perception that some state foreclosure laws are insufficiently protective of certain interests.[27] Such concerns are based on a political judgment that a particular State has struck the wrong balance between mortgagors and mortgagees. But in the absence of a clear statement by Congress, a federal standard of price adequacy applicable to foreclosure sales followed by bankruptcy represents a constitutionally infirm and ultimately counterproductive means of seeking to achieve desired changes in state foreclosure law. As one commentator has noted,

> It is not, in any case, the function of the federal Bankruptcy Code to attack collaterally what one does not like in state law. Using the Bankruptcy Code for something it was not intended to do can only result in adverse consequences to the well-ordered administration of bankruptcy and the smooth functioning of the economy of the nation.

Zinman, *Nonfraudulent Transfers*, 9 Cardozo Law Review at 603. *See also* Henning, 63 N.C.L. Rev. at 285 (as a means of correcting deficiencies in state foreclosure law, *Durrett* is a "blunt instrument forged from statutes that were not drafted with such a doctrine in mind.").

Reading a federal standard of price adequacy into Section 548 would create a problematic dual system in which bankruptcy triggers new rules regarding the analysis of completed foreclosure sales. Such an outcome is wholly contrary to this Court's stated interest in "discourag[ing] forum shopping" and "prevent[ing] a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner*, 440 U.S. at 55 (quoting *Lewis*, 364 U.S. at 609).

Moreover, because the added federal level of protection in the foreclosure realm would extend only to those cases in which foreclosure is followed by bankruptcy, it

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[27] *See* Br. *Am. Cur.* of Frank Allen at 43-46; Ehrlich, 71 Va. L. Rev. at 962, 975.

would leave state law determinative as to those foreclosure sales *not* followed by bankruptcy. Faced with a dual system in which their own laws are rendered irrelevant when foreclosure is followed by bankruptcy, States would be seriously impeded in their efforts to weigh competing interests and strike an appropriate balance for the remaining universe of cases. The further development of state law would be improperly hindered by such a rule.

CONCLUSION

The judgment of the court of appeals should be affirmed.

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August 23, 1993